the MFJ proceedings, the BOCs have numerous ways in which they could -- and previously did -- use their bottleneck control to the disadvantage of their competitors. That is what the AT&T divestiture, and the years of litigation leading up to the consent decree, was all about.

For example, the BOC would have the incentive to and could cross-subsidize their competitive IXC services with exchange access revenues. Cost shifting is extremely difficult to detect and remedy. The BOCs could increase IXC prices across the board by shifting costs from their own interLATA services to the access services upon which all IXCs rely. The BOCs' total profits would not suffer from such cost-shifting from one product to another. Non-BOC IXC competitors, however, would be injured because access price increases directly affect their profit levels.[15/]

The FCC has no existing safeguards that could be modified easily to protect against such cross-subsidization. Price cap regulation would not be an effective deterrent as noted by Commissioner Barrett who stated that he does "not believe that price cap regulation alone removes the potential or the actual ability of the [BOCs] to cross-subsidize services" (released October 15, 1990). The Commission's Part 64 joint cost

---

[15/] AT&T pays the BOCs 45 cents out of every dollar it collects for long distance service. "Carriers Fight Back," Communications Week, August 9, 1993, at 25. Under the Commission's new access transport pricing rules in CC Docket No. 91-213, small IXCs such as CNS will be required to pay even higher access charges than AT&T pays, and, thus, would find it even more difficult to compete against the LECs than AT&T would.

allocation rules are no help either. As the BOCs acknowledge, Petition at 36-37, those procedures were established to allocate shared capital costs and expenses between regulated and nonregulated activities. The Commission has not established procedures for allocating joint costs between regulated IXC and regulated local exchange services, and certainly such procedures would need to be more detailed and contain more specificity than the existing procedures.

In any event, relying on accounting safeguards and audits as the principal regulatory means of detecting and preventing cross-subsidization is wholly inadequate, considering the current dominant market power of the BOCs. Such nonstructural safeguards depend upon the inherently subjective and error-prone task of examining and judging complex accounting procedures and cost allocations. Independent reports to Congress prepared by the General Accounting Office ("GAO") have documented the FCC's inability to control cross-subsidies solely through the use of cost allocation techniques and other nonstructural safeguards. A 1987 GAO Report concluded that "[t]he level of oversight FCC is prepared to provide will not, in GAO's opinion, provide telephone ratepayers or competitors positive assurance that FCC cost allocation rules and procedures are properly controlling cross-subsidy."[16/] That report cited the FCC's past

---

16/ GAO Report to the Chairman, Subcommittee on Telecommunications and Finance, Committee on Energy and Committee, House of Representatives, Telephone Communications, Controlling Cross-Subsidy Between Regulated and Competitive

(continued...)

difficulties with allocating costs in the absence of a structural separation requirement.[17/] The 1987 GAO Report also found that the independent audit requirement would not relieve the Commission of the need for substantial involvement and oversight responsibility. Id. at 47. Given the FCC's required oversight role, the 1987 GAO Report showed that at 1987 staff levels, the FCC would be capable of conducting a full audit of major LECs only once every 16 years.[18/]

In mid-1990, after media coverage of three cases of possible cross-subsidization had raised renewed concerns in Congress, the Chairman of the House Telecommunications Subcommittee requested the GAO to conduct a follow-up inquiry into the FCC's capabilities to detect telephone company cross-subsidies. Communications Daily, July 23, 1990 at 8. The letter specifically asked the GAO to examine the FCC's ability to uncover cross-subsidies on its own, rather than "first reading about it in the press." Id.

16/ (...continued)
Services, GAO/RCED-88-34, October 1987, at 3) ("1987 GAO Report.")

17/ Id. at 15-21. The GAO criticized the FCC's cost allocation approach for, among other reasons, leaving a small audit staff with a major oversight role, requiring heavy reliance on an untested computer program, curtailing the ability of the public to file comments and complaints, and limiting the scope of the joint cost rules. Id. at 38, 40-41, 42, 45.

18/ Id. at 52-53. The size of the FCC's audit staff (15) was the same in 1991 as it was in 1987, even as the task of monitoring cost allocations had grown.

The 1993 GAO Report contained even more compelling evidence of the FCC's inability to regulate LEC cross-subsidies than its predecessor.[19] For example, the follow-up report found that FCC audit staffing levels still are not adequate to oversee cost allocations, and had even deteriorated since 1987:

> In 1987, we reported that FCC had insufficient staff to ensure that consumers were protected from cross-subsidization. Since that time, FCC's responsibility for overseeing carriers' cost allocations have continued to grow, but the staff resources allocated to this function have declined rather than increased. We believe the number of FCC auditors remains inadequate to provide a positive assurance that ratepayers are protected from cross-subsidization.[20]

Acting Chairman Quello expressly endorsed the findings of the 1993 GAO Report and noted that "we lack enough auditors to do as much common carrier auditing as we are expected to do." June Quello Statement, supra, at 6 and 8. The FCC's auditing staff as of September 1992 was even smaller than in 1987 and could conduct an audit of the highest priority areas only once every 11 years and of all areas only once every 18 years. 1993 GAO Report at 2. The 1993 GAO Report concluded that the FCC's nonstructural safeguards cannot detect all cross-subsidies.[21]

---

[19] GAO Report to Congressional Requesters, FCC Oversight Efforts to Control Cross-Subsidization, GAO/RCED-93-34 (Feb. 1993) ("1993 GAO Report").

[20] Id. at 12.

[21] Id. The 1993 GAO Report notes that the FCC's Common Carrier Bureau "generally agreed with the factual information in the report." Id. at 13.

The BOCs' control over network design also provides them with opportunities for anti-competitive conduct that are almost impossible to prove. An IXC competitor proposing a new service or new interface with the local exchange would be required to provide detailed information to the BOCs. Because of their bottleneck control, the BOCs could delay introduction of the new service or interface until they could develop a similar offering. Similarly, if the BOCs develop new access technologies, they could deploy them first in those central offices that serve their IXC affiliates before deploying the new technologies in the central offices serving their competitors.

The BOCs also could act anti-competitively against IXC competitors through their access to customer proprietary network information (CPNI). As a result of their bottleneck monopoly, the BOCs would have early access to customer information about in-house data operations, communications interface requirements, and expansion plans. The BOCs could identify the most rapidly growing IXC service areas and target the largest volume customers of their IXC competitors, using information access unavailable to their competitors. Similarly, the BOCs could use to their competitive advantage information obtained from the competing IXCs themselves regarding the location, distribution and volume of the traffic they plan to handle and the type of interface equipment required to interconnect with the BOCs' bottleneck exchange.

Finally, the BOCs could engage in price discrimination against their IXC competitors. The Huber Report submitted by the DOJ in the triennial review proceeding explained that "[m]ost [local exchange carriers] still discriminate among users in the prices they charge for functionally identical switched lines."[22/] The FCC's ongoing tariff investigation of the BOCs' expanded interconnection tariffs illustrate some of the ways the BOCs discriminate against potential competitors. A number of competing CAPs provided data showing that, in a number of cases, the recurring and nonrecurring rates for physical collocation arrangements for CAPs result in total costs to the collocator that approach or exceed the BOCs' tariffed end-to-end DS1 service, thereby making it impossible for collocators to compete with the BOCs. Ameritech Operating Companies, et al., CC Docket No. 93-162, DA 93-657, June 9, 1993 at para. 8. The Common Carrier Bureau already has found that the BOCs unreasonably applied overhead loading factors to calculate the rates for the interconnection services specifically designed for the emerging CAP competitors that were substantially higher than the overhead factors the BOCs applied to all other special access services not designed for potential competitors. Id. at paras. 32-34. The Commission also has acknowledged the validity of CAP competitors' complaints that the BOCs have applied the non-recurring charges (NRCs) for service reconfigurations in a discriminatory manner to

---

[22/] P. Huber, The Geodesic Network: 1987 Report on Competition in the Telephone Industry, at 2.9.

the disadvantage of the BOCs' emerging competition. See FCC Public Notice Report No. D-2473, CC Docket No. 91-141, August 3, 1993, at 2.

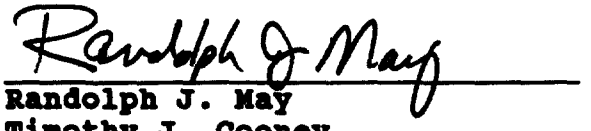
In sum, the motivation and the means to discriminate against potential or actual interexchange competitors has not diminished materially since the entry of the MFJ or as the result of FCC regulations. For this reason, even if the Commission does not dismiss the Petition summarily as moot and a waste of Commission resources -- which, in fact, it should do -- the Commission should deny the Petition on substantive grounds.

IV. CONCLUSION.

For the reasons stated above, the Commission should dismiss and/or deny the BOCs' Petition for Rulemaking.

Respectfully submitted,

CAPITAL NETWORK SYSTEM, INC.



Randolph J. May
Timothy J. Cooney
SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Ave., N.W.
Washington, D.C. 20004-2404
(202) 383-0100

September 2, 1993

Its Attorneys

CERTIFICATE OF SERVICE

I, Marcia Towne Devens, do hereby certify that true and correct copies of the foregoing document, "OPPOSITION OF CAPITAL NETWORK SYSTEM, INC.," were served by U.S. Mail, postage prepaid, this 2nd day of September, 1993, on the following:

* Acting Chairman James H. Quello
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

* Commissioner Andrew C. Barrett
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

* Commissioner Ervin S. Duggan
Federal Communications Commission
1919 M Street, N.W., Room 832
Washington, D.C. 20554

* Kathleen Levitz
Acting Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

* Jill Ross-Meltzer
Associate Bureau Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

* James D. Schlichting
Chief, Policy & Program Planning Division
Federal Communications Commission
1919 M Street, N.W., Room 544
Washington, D.C. 20554

Edward D. Young, III
John M. Goodman
Bell Atlantic
1710 H Street, N.W.
Washington, D.C. 20006

William Barfield
Richard Sbaratta
BellSouth Corporation
1155 Peachtree Street, N.E.
Suite 1800
Atlanta, Georgia 30367

Gerald E. Murray
Thomas J. Hearity
NYNEX Corporation
1113 Westchester Avenue
White Plains, New York 10604

James P. Tuthill
Alan F. Ciamporcero
Pacific Telesis Corporation
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Michael K. Kellogg
Kellogg, Huber & Hansen
1301 K Street, N.W.
Suite 1040E
Washington, D.C. 20005

Paul Lane
Dale E. Hartung
Thomas J. Horn
Southwestern Bell Corporation
175 East Houston
Room 1260
San Antonio, Texas 78205

Martin E. Grambow
Southwestern Bell Corporation
1667 K Street, N.W.
Washington, D.C. 20006

---

*/ (Served by hand delivery)

Marcia Towne Devens